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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Panamanian Economy--What Might Go Wrong

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
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INTELLIGENCE MEMORANDUM

The Panamanian Economy--What Might Go Wrong

Summary

The Panamanian Government dominated by General Torrijos has thus far had little trouble coping with challenges from the National Guard and from the followers of deposed President Arias. The next crisis, however, may be of the government's own making. In mid-1969, the Torrijos regime instituted an expensive public works program in order to counter the decline in private domestic investment and to improve its political image. Since then, private investment has not revived as the regime had hoped because many businessmen remain suspicious of Torrijos' ultimate aims and are uncertain about the economy's short-term prospects. The government is now gambling on its continued ability to obtain foreign loans to sustain its increased public works programs. If substantial assistance is not forthcoming because foreign lenders become frightened by the government's revolutionary rhetoric or the deteriorating financial situation, an economic and political crisis of major dimensions could result, with inevitable implications for Panamanian-US relations.

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Current Intelligence and coordinated with the Office of Economic Research, the Office of National Estimates and the Clandestine Service.

1. The Torrijos regime has repeatedly made clear its distrust of the oligarchy and its determination to exclude the traditional oligarchy-dominated political parties from the political process. It also hoped, however, to encourage investment, and until recently has refrained from measures that would adversely affect the economic interests of this group. The government has tried to maintain a distinction between economics and politics, but the business community suspects it nevertheless and has demonstrated this suspicion by a kind of passive resistance--a reluctance to invest in the economy.

2. The government has taken up the slack by resorting to a public works program that has pumped extra dollars into the economy, thereby sustaining employment and consumer demand and contributing to an upturn in economic activity. Hopes that this expensive program could soon be scaled down have been frustrated by the continued stagnation of domestic private investment at little more than half the 1967 level. As a result, the budget deficit has increased substantially and the government has been compelled to obtain short-term, high-interest foreign loans. Because US currency is the main medium of exchange, the government cannot simply print money to cover budget deficits but must rely on domestic and foreign borrowing.

3. Public works spending in 1969 boosted the deficit to $37 million (or 22 percent of total expenditures), and at times a financial crisis seemed imminent. To help cover its deficit and repay earlier credits, the government obtained $22 million from US banks in short-term loans, most of which fall due this August. Domestic credit sources available to the government have now been nearly exhausted. The government ran up a debt of about $28 million with the National Bank by March 1970--the limit under the standby credit agreement with the International Monetary Fund (IMF). It also has borrowed extensively from the social security fund and has sold about as many bonds as the domestic capital market will absorb. Since December the regime has been strapped for funds. It could not pay

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a recent water bill from the Panama Canal Company, for example, and did not even have enough money to pay cash for an ad in the New York Times.

4. To ease its financial problems this year, the government has raised taxes by $11 million and will be able to draw on the $10 million IMF credit, provided that it meets certain prescribed conditions. [redacted] 25X1

25X1 [redacted] Panama is also scheduled to receive about $27 million in long-term development funds from various international sources in 1970. In order to make full use of this aid, however, the government will have to come up with $16 million of its own funds in addition to the nearly $22 million it will need to pay off the short-term debts that fall due this summer. 25X1

25X1 5. [redacted] In addition, publicity about the Boston Panama case could add further complications. The Panamanian Government accused this US-owned company of failing to pay taxes on uncultivated land, and last year seized 200,000 hectares of its property. The company has not yet exhausted its legal remedies; nevertheless, charges of expropriation could discourage foreign lenders.

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7. Although the economy is basically healthy and the long-term prognosis is good, short-term financial difficulties are likely to persist because of the government's precarious cash situation and its current dependence on periodic injections of foreign credit. Particularly significant is the delicate interrelationship among political stability, investor confidence, and the availability of credit. The government had expected to receive a $10-million loan last December, but the abortive coup that month made this impossible, and it was actually placed in March. Any new evidence of political instability or any additional cutbacks in domestic private-sector investment could delay future loans.

8. If Torrijos cannot come up with additional financial resources, he will either have to raise taxes again--always a distasteful and unpopular step--or reduce public investment expenditures. The latter step could bring about a temporary slowdown in economic growth and in the highly visible and politically necessary public works program. The resulting unemployment and reduced demand could cause a further weakening in investor confidence. This, in turn, could lead to dampened business activity, capital flight, more unemployment, and increased difficulties in generating the necessary funds for government programs. Some of these reactions might be motivated by more than strictly economic considerations because the oligarchy is less than pleased with Torrijos and would welcome an opportunity to hasten his political demise.

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9. Faced with large revenue shortfalls and unable to borrow abroad, the government would be likely to adopt more statist economic policies, try to prevent capital flight, and perhaps force domestic capital into socially and politically desirable channels. Torrijos has already decreed a government take-over of workmen's compensation insurance, which had previously been handled by private companies [redacted] 25X1 This may indicate that Torrijos has already concluded that it is impossible for him to restore business confidence and, making a virtue of necessity, is seeking to expand his power base by adopting policies that will enhance his revolutionary image and increase his popular support. Even if Torrijos has not yet written off the business community, he has increased the gulf between government and business. Bankers and other businessmen have already expressed concern that Torrijos might move against them, as he has against the insurance industry.

10. In his search for government revenue, Torrijos may also try to put the pinch on the US. He is probably aware that his economic difficulties would be nonexistent if he were receiving the $20 million in canal revenues proposed in the 1967 draft treaties instead of the present $1.9 million annual payment. Pressure for additional US assistance and increased benefits from the canal could, therefore, quickly mount and grow insistent.

11. If it should be impossible to raise all the money needed, the question of priorities then becomes important. The government is currently trying to shift some emphasis from pump-priming public works projects toward expenditures for agriculture, health, and electrification. De La Ossa, Ardito Barletta, and Minister of Commerce and Industry Manfredo appear to favor increased aid to agriculture, and from an economic point

of view their position makes sense. Nevertheless, the rural farmer is not causing trouble, and it could be politically dangerous to cut back on public works projects that benefit urban labor. Torrijos, therefore, might be forced to choose between alienating his economic planners and risking popular discontent. Moreover, if De La Ossa and others resign over economic policy differences, the international financial community would be deeply concerned, and additional funding might be even more difficult to obtain. A point worth noting in this regard is that the Rio Hato base agreement with the US expires on 26 August, approximately the same time that the short-term debt falls due. It would be surprising if a financially troubled government did not draw the obvious conclusion and demand a high price for extension of the agreement.

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